EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 20 May 2020

Assessment of the 2020 Convergence Programme for

Croatia

(Note prepared by DG ECFIN staff)

CONTENTS

EXECUTIVE SUMMARY 3

1. INTRODUCTION 4

2. MACROECONOMIC DEVELOPMENTS 4

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS 7

3.1. DEFICIT DEVELOPMENTS AND MEDIUM-TERM STRATEGY AND TARGETS 7

3.2. MEASURES UNDERPINNING THE PROGRAMME 9

3.3. DEBT DEVELOPMENTS 10

3.4. RISK ASSESSMENT 11

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT 12

4.1. Compliance with the debt criterion 12

4.2. Compliance with the deficit criterion 12

4.3. Compliance with the MTO in 2019 12

EXECUTIVE SUMMARY

- On 6 April 2020, the Commission provided guidelines to Economic and Financial Committee on how the format and content of the 2020 Stability and Convergence Programmes can be streamlined in light of the exceptional circumstances related to the COVID-19 pandemic. This assessment takes into account the severe constraints that Member States faced in providing the information usually required in their Programmes. The assessment focuses on the near term in light of the high uncertainty attached to the projections.
- Croatia's economy grew by 2.9% in 2019. The 2020 Convergence Programme and the Commission 2020 spring forecast both project a severe contraction of economic activity (of more than 9%) in 2020, followed by a fast recovery in 2021 (of 6.1%), which would still not be enough to bring the volume of output back to its 2019 level.
- The Convergence Programme projects the general government debt to peak at just below 87% in 2020, 2 percentage points below the Commission's forecast. In 2021, the Commission and the Convergence Programme both project the government debt to drop below 84% of GDP
- The budgetary outlook is similar in the two projections. The Commission 2020 spring forecast and the Convergence Programme project the 2020 deficit slightly over and below 7% of GDP, respectively. In 2021, the deficit is expected to ease to slightly above 2% of GDP.
- The main policy measures aimed at countering the economic fallout of the COVID-19 pandemic include the subsidy paid out to businesses for retaining employees and tax cancellations granted to hardest-hit businesses. The two measures are estimated in the Convergence Programme to cost 2.7% of GDP.
- The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic.

1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2020 Convergence Programme of Croatia covering the period 2020-2021 (hereafter called the Programme), which was submitted on 30 April 2020[1], the same day that the government approved it. The note also assesses Croatia's compliance with the preventive arm of the Stability and Growth Pact in 2019.

Croatia is currently subject to the preventive arm of the Stability and Growth Pact (SGP). As the debt ratio was 73.2% of GDP in 2019, exceeding the 60% of GDP reference value, Croatia is also subject to the debt reduction benchmark.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit the activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Croatia is among those Member States who have triggered national escape clauses to suspend budgetary constraints set by their national fiscal rules 2020 as part of the effort to accommodate the budgetary implications of the outbreak.

2. MACROECONOMIC DEVELOPMENTS

In 2019, domestic demand drove real GDP growth (2.9%) as investment and government consumption picked up, while continued improvements in the labour market and low inflation underpinned private consumption. Growth of exports rebounded sharply, but its contribution to real GDP growth was offset by strong growth of imports.

Croatia responded fast to the COVID-19 pandemic. The pandemic containment measures introduced as of mid-March included the physical closure of schools and universities (with education activities continuing via distance learning tools), limitations on movements within the country and across borders, mandatory quarantine for incoming travellers from the most affected areas, bans on public

[1] The Convergence Programme contains only short-term budgetary projections, in line with the guidelines for a streamlined format of the 2020 Stability and Convergence Programmes in light of the COVID-19 outbreak, provided by the Commission services on 6 April 2020.

gatherings and closure of all non-essential shops. A gradual three-phased easing of the restrictions started on 27 April.

The macroeconomic scenario underpinning the Programme projects a sharp recession due to the COVID-19 pandemic. Real GDP is projected to fall by 9.4% in 2020 and to partially recover by 6.1% in 2021. The economic shock due to the pandemic suppression measures is expected to be strongest in the second quarter of 2020. All GDP demand components are projected to decline substantially. Domestic demand is expected to provide the biggest negative contribution to growth in 2020, but it is also expected to drive the recovery in 2021. Exports are projected to contract sharply owing primarily to services (tourism). Consumer price inflation is expected to turn negative, also under the impact of the collapse in energy prices. Employment is forecast to decline by 3.3% in 2020, bringing the unemployment rate up to 9.5%. The labour market is expected to recover moderately in 2021.

Table 1: Comparison of macroeconomic developments and forecasts

	2019		2020		2021		2022	2023
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	2.9	2.9	-9.1	-9.4	7.5	6.1	n.a.	n.a.
Private consumption (% change)	3.5	3.5	-6.9	-7.0	6.1	5.8	n.a.	n.a.
Gross fixed capital formation (% change)	7.1	7.1	-8.2	-9.0	4.2	5.6	n.a.	n.a.
Exports of goods and services (% change)	4.6	4.6	-29.0	-30.0	33.7	32.5	n.a.	n.a.
Imports of goods and services (% change)	4.8	4.8	-21.2	-23.4	23.4	27.6	n.a.	n.a.
Contributions to real GDP growth:							n.a.	n.a.
- Final domestic demand	4.1	4.1	-5.2	-5.3	4.5	5.2	n.a.	n.a.
- Change in inventories	-1.0	-1.0	0.0	-0.9	0.0	0.1	n.a.	n.a.
- Net exports	-0.1	-0.1	-3.9	-3.3	3.0	0.8	n.a.	n.a.
Output gap[1]	3.7	4.0	-6.1	-6.0	-0.7	-1.9	n.a.	n.a.
Employment (% change)	1.4	1.4	-3.9	-3.3	3.0	1.5	n.a.	n.a.
Unemployment rate (%)	6.6	6.6	10.2	9.5	7.4	9.0	n.a.	n.a.
Labour productivity (% change)	1.5	n.a.	-5.5	n.a.	4.3	n.a.	n.a.	n.a.
HICP inflation (%)	0.8	0.8	0.4	-0.3	0.9	0.9	n.a.	n.a.
GDP deflator (% change)	1.5	1.5	0.7	0.1	0.9	1.1	n.a.	n.a.
Comp. of employees (per head, % change)	3.4	n.a.	-1.2	n.a.	1.1	n.a.	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2020 spring forecast (COM); Convergence Programme (CP).

Given the size of the economic disruption caused by the COVID-19 pandemic and the uncertainties surrounding its size and duration, differences between the economic scenarios presented in the Convergence Programme and in the Commission 2020 spring forecast (hereafter Commission forecast) are small. The latter projects a slightly smaller contraction of real GDP in 2020, and a stronger

recovery in 2021. Conversely, the Commission forecast projects a slightly stronger adjustment in the labour market than the Programme in 2020. The Commission does not expect deflation in consumer prices and projects a slightly higher overall GDP deflator in 2020.

On 11 May, the Fiscal Policy Commission (Croatia's independent fiscal institution) issued an opinion[2] stating that, while it found the macroeconomic scenario and the budgetary projections appropriate on the basis of their similarity to the Commission's forecast, it did not find them sufficiently conservative. In the context of significant downside risks to both, the Fiscal Policy Commission warned about the need for continuous monitoring of the situation and timely adjustment of fiscal policy in case the risks materialise.

[2] Available at : https://www.sabor.hr/sites/default/files/uploads/inline-files/6.%20Stajali%C5%A1te%20Povjerenstva%20za%20fiskalnu%20politiku.pdf

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS AND MEDIUM-TERM STRATEGY AND TARGETS[3]

In 2019, Croatia's general government balance remained positive (0.4% of GDP), substantially overperforming the target set in the 2019 Convergence Programme (-0.3% of GDP). The better-than-planned outturn owes largely to the underestimation of revenue growth in the 2019 programme, by almost 2 percentage points. Tax revenue was particularly underestimated, which is explained in part by a 0.5 percentage point stronger than projected nominal GDP growth and in part by tax revenue growth outpacing nominal GDP growth in spite of cuts. Meanwhile, expenditures grew slightly more than projected (6.3% vis-à-vis 6%), mostly due to the wage bill, capital transfers and investment, while subsidies and interest spending came in lower than projected.

In 2020, the Programme projects the headline balance to plummet to -6.8% of GDP. , close to the -7.1% in the Commission forecast. This is due to the effect of automatic stabilisers and the budgetary impact of measures adopted in response to the COVID-19 outbreak. In fact, the projected deterioration is largely the result of a decline in revenue by more than 11%, very close to the Commission's forecast. Meanwhile, the planned big increase in subsidies (resulting from the COVID response package, see Section 3.2) is projected to be largely offset by cuts in capital and interest spending, resulting in more contained expenditure growth than in the Commission's forecast. The cumulative impact of the deficit-increasing measures put in place to contain the COVID-19 pandemic and countering the ensuing economic fallout is projected at 2.8% of GDP in the Convergence programme, less than the Commission's estimate of 3.4% of GDP (see section 3.2.).

In 2021, the Convergence Programme projects the headline deficit to improve to 2.4% of GDP, similar to the 2.2% of GDP in the Commission forecast. The projected improvement owes primarily to a rebound in revenues as the economy and the labour market recover as well as the base effect from the phasing out of the tax cancellation measures. Meanwhile, expenditure growth is projected to remain muted on aggregate, as subsidies drop compared to 2020 and debt servicing costs decline.

Overall, the envisaged budgetary outlook is deemed consistent with the macroeconomic scenario and budgetary measures underpinning the programme.

[3] In light of the activation of the general escape clause, the measures taken in response to the coronavirus outbreak in 2020 are not treated as one-off and are thus not excluded from the estimation of the structural budget balance.

Table 2: General government budgetary position

(% of GDP)	2019	2020		2021		2022	2023	Change: 2019-2023
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**47.5**	**46.3**	**46.4**	**47.4**	**47.8**	**n.a.**	**n.a.**	**n.a.**
of which:								
- Taxes on production and imports	20.3	19.7	18.4	19.9	20.2	n.a.	n.a.	**n.a.**
- Current taxes on income, wealth, etc.	6.7	5.5	6.1	5.7	6.2	n.a.	n.a.	**n.a.**
- Social contributions	11.8	11.0	12.0	11.8	12.3	n.a.	n.a.	**n.a.**
- Other (residual)	8.7	10.0	9.9	9.9	9.1	n.a.	n.a.	**n.a.**
Expenditure	**47.1**	**53.4**	**53.3**	**49.6**	**50.2**	**n.a.**	**n.a.**	**n.a.**
of which:								
- Primary expenditure	44.9	51.1	51.2	47.3	48.2	n.a.	n.a.	**n.a.**
of which:								
Compensation of employees+Intermediate consumption	20.2	22.4	22.8	21.5	22.1	n.a.	n.a.	**n.a.**
Compensation of employees	11.9	13.1	13.3	12.7	12.8	n.a.	n.a.	**n.a.**
Intermediate consumption	8.3	9.3	9.5	8.8	9.4	n.a.	n.a.	**n.a.**
Social payments	15.5	17.8	17.7	17.0	17.1	n.a.	n.a.	**n.a.**
Subsidies	1.5	3.4	3.5	1.7	1.6	n.a.	n.a.	**n.a.**
Gross fixed capital formation	4.3	4.3	4.1	4.2	4.4	n.a.	n.a.	**n.a.**
Other (residual)	3.3	3.1	3.1	2.9	3.1	n.a.	n.a.	**n.a.**
- Interest expenditure	2.2	2.3	2.1	2.3	2.0	n.a.	n.a.	**n.a.**
General government balance (GGB)	**0.4**	**-7.1**	**-6.8**	**-2.2**	**-2.4**	**n.a.**	**n.a.**	**n.a.**
Primary balance	**2.6**	**-4.8**	**-4.7**	**0.1**	**-0.4**	**n.a.**	**n.a.**	**n.a.**
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	n.a.	n.a.	**n.a.**
GGB excl. one-offs	**0.4**	**-7.1**	**-6.8**	**-2.2**	**-2.4**	**n.a.**	**n.a.**	**n.a.**
Output gap[1]	3.7	-6.1	-6.0	-0.7	-1.9	n.a.	n.a.	**n.a.**
Cyclically-adjusted balance[1]	-1.2	-4.4	-4.0	-1.9	-1.5	n.a.	n.a.	**n.a.**
Structural balance[2]	**-1.2**	**-4.4**	**-4.0**	**-1.9**	**-1.5**	**n.a.**	**n.a.**	**n.a.**
Structural primary balance[2]	1.0	-2.1	-1.9	0.4	0.5	n.a.	n.a.	**n.a.**
Gross debt ratio	**73.2**	**88.6**	**86.7**	**83.4**	**83.2**	**n.a.**	**n.a.**	**n.a.**

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Convergence Programme (CP); Commission 2020 spring forecasts (COM); Commission calculations.

3.2. MEASURES UNDERPINNING THE PROGRAMME

The main fiscal measures aimed at countering the economic fallout of the COVID-19 pandemic include temporary tax cancellations on the revenue side and subsidies for retaining employees paid out to businesses on the expenditure side.[4] The tax cancellations were designed to alleviate the burden on businesses whose revenues are most negatively affected, with a focus on smaller ones. Namely, the government waives the payment of personal income tax, corporate income tax and social contributions during the second quarter of 2020 for companies with revenues up to HRK 7.5m (EUR 1m) that experience a drop in revenue by 50% or more. For companies with revenue above the HRK 7.5m threshold that experience a drop in revenues of 50% or more, the share of tax cancellation equals the rate of the drop in revenue. Subsidies for retaining employees are also paid out in the second quarter of 2020 to companies that apply and fulfil several criteria related to a decline in revenue and retention of employees. The amount of the subsidy per employee is equal to the minimum wage in March (HRK 3 250) and is somewhat higher in April and May (HRK 4 000). On top of these amounts, the measure includes the payment of all social contributions applicable to those amounts, the bulk of which comprises general government revenue, with the exception of the 2nd pillar contributions (reported under social benefits in Table 3). Finally, there is the cost of the additional medical equipment already procured. In total, the programme reports the impact of these fiscal measures at 2.8% of GDP, somewhat less than the Commission's estimate of 3.4% of GDP, largely on account of differing assumptions underpinning the projections related to temporary tax cancellations.

In addition to the above fiscal measures with a deficit-increasing impact in 2020, the Convergence Programme lists liquidity measures in the amount of 1.3% of GDP. These mostly relate to tax deferrals up to 24 months granted to businesses that experience a drop in revenue lower than 50%, the remainder being the within-year deferral of corporate income tax liability.

Overall, the measures taken by Croatia are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak. [5] These temporary measures appear timely and relatively well targeted. The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term. However, in the case of tax cancellations and tax deferrals, a possible shortcoming is the cliff edge effect that the combination of eligibility conditions (set in terms of revenue thresholds as outlined above) could create. This could result in unequal treatment of beneficiaries in similar situations and perverse incentives for businesses experiencing a drop in revenue close to 50%. The take-up of the measures has been relatively strong, in line with expectations. The wage subsidy was taken up by almost 84 000 businesses, covering 485 000 employees in March.

---

[4] These measures were available in time and were sufficiently detailed to be included in the Commission forecast.

[5] https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020_en.pdf

Croatia did not submit the standard table on guarantees adopted or announced in response to the COVID-19 outbreak.

Table 3: Discretionary measures adopted in response to COVID-19 outbreak

List of measures	Description	ESA Code (Expenditure / Revenue component)	Adoption Status	Budgetary impact (% of GDP)	
					2020
1.a	Personal income tax deferral	D.5r	Adopted		0.1
1.b	Corporate income tax deferral	D.5r	Adopted		0.1
1.c	Health insurance contribution deferral	D.61r	Adopted		0.2
1.d	Pension insurance contribution deferral	D.61r	Adopted		0.3
2.a	Personal income tax cancellation	D.5r	Adopted		0.1
2.b	Corporate income tax cancellation	D.5r	Adopted		0.1
2.c	Health insurance contribution cancellation	D.61r	Adopted		0.2
2.d	Pension insurance contribution cancellation	D.61r	Adopted		0.3
3	Deferral of payment of 2019 corporate income tax until July 2020	D.5r	Adopted		0.6
4	Support to businesses for retaining employees	D.3p	Adopted		1.9
4	Support to businesses for retaining employees	D.62p	Adopted		0.1
5	Procurement of medical equipment	P.2	Adopted		0.2
				Total	**4.1**

Source: Convergence Programme

3.3. DEBT DEVELOPMENTS

In 2019, the government debt-to-GDP ratio decreased to 73.2% from 74.7% in 2018. The reduction was driven by robust nominal GDP growth and a headline surplus, partly offset by a sizable gross debt-increasing stock-flow adjustment as the government issued debt in excess of its financing needs to build up its liquidity buffer in the form of deposits.

In 2020, the Programme projects the debt ratio to rise by 13.5 percentage points, around 2 percentage points less than the Commission 2020 spring forecast. The difference stems from the stock-flow adjustment projections, whereas the contributions of the primary balance and the snowball effect are projected at broadly similar levels. Namely, while the Programme projects a negative stock-flow adjustment of 0.9% of GDP in 2020, the Commission forecast projects a positive one,

of 1.5% of GDP on account of liquidity measures put in place to support firms (tax deferrals up to 24 months) which do not affect the deficit in accrual terms[6]. The Commission forecasts the general government debt to fall to 83.4% of GDP in 2021, similar to the Programme (83.2% of GDP), as economic growth is expected to resume and temporary relief measures are phased out.

Table 4: Debt developments

(% of GDP)	Average 2014-2018	2019	2020		2021		2022	2023
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**80.5**	**73.2**	**88.6**	**86.7**	**83.4**	**83.2**		
Change in the ratio	-1.3	-1.5	15.4	13.5	-5.2	-3.5	n.a.	n.a.
Contributions [2] :								
1. Primary balance	**-1.3**	**-2.6**	**4.8**	**4.7**	**-0.1**	**0.4**	**n.a.**	**n.a.**
2. "Snow-ball" effect	**0.7**	**-0.9**	**9.0**	**9.6**	**-4.6**	**-3.8**	**n.a.**	**n.a.**
Of which:								
Interest expenditure	3.0	2.2	2.3	2.1	2.3	2.0	n.a.	n.a.
Growth effect	-1.8	-2.1	7.3	7.6	-6.1	-4.9	n.a.	n.a.
Inflation effect	-0.5	-1.1	-0.6	-0.1	-0.8	-0.9	n.a.	n.a.
3. Stock-flow adjustment	**-0.7**	**2.1**	**1.5**	**-0.9**	**-0.5**	**0.0**	**n.a.**	**n.a.**

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the

Source :

Commission 2020 spring forecast (COM); Convergence Programme (CP), Commission calculations.

3.4. RISK ASSESSMENT

The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. The pandemic could become more severe and last longer than assumed, requiring more stringent and longer lasting containment measures. This would result in worse economic and fiscal outcomes. It could also require further fiscal policy measures. That would result in worse fiscal outcomes but help to mitigate the economic impact.

In Croatia, the uncertainty on the duration of the pandemic is particularly pertinent in view of the economy's reliance on (inbound) tourism. In the medium term, possible increased aversion towards international travel could weigh on the recovery of exports of services. Finally, the still relatively high private sector debt could contribute to a rise in bankruptcies that could exacerbate the recession and weigh on the

[6] The deferred tax liability, even if paid in subsequent years, should be recorded as revenue in 2020 in accrual terms. In that sense, the measure does not have a deficit-increasing effect in 2020. However, in cash terms, the absence of cash receipts will need to be funded, thus increasing the debt. This is accounted for through stock-flow adjustment.

recovery. The Programme broadly acknowledges these risks and in addition stresses the risk of the pandemic exacerbating the pre-existing geopolitical global risks.

There is also a risk of underestimating the fiscal impact of the measures introduced to tackle the economic fallout of the pandemic. The impact of tax cancellations is particularly difficult to assess, as it depends on numerous assumptions concerning the take-up of the measure and the structural characteristics of its beneficiaries (employment, wages and profitability). In addition, there is a high risk that part of the deferred taxes will not be repaid after the expiry of the 24-month grace period.

Finally, implementing expenditure cuts that would allow accommodating the new sizable measures (most notably the subsidy for retaining employment) within the planned total expenditure growth could prove challenging. Risks to the budgetary projections are compounded by weaknesses in the national budgetary framework, notably the fact that the Fiscal Policy Commission has not been strengthened in line with legal requirements and provisions on medium-term planning and forecasting are not in place.

4. Compliance with the provisions of the Stability and Growth Pact

4.1. Compliance with the debt criterion

According to notified and validated data, the general government gross debt stood at 73.2% of GDP at the end of 2019, above the 60% of GDP Treaty reference value. This suggests that Croatia complied with the debt reduction benchmark in 2019.

Based on the Commission forecast, the debt benchmark is expected not to be met in both 2020 and 2021, whereas the Programme does not contain enough information to assess compliance.

4.2. Compliance with the deficit criterion

According to the Convergence Programme, Croatia's general government deficit is expected to reach 6.8% of GDP in 2020, thereby exceeding the Treaty reference value of 3% of GDP. This provides prima facie evidence of the existence of an excessive deficit in Croatia for the purposes of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU, which analyses Croatia's compliance with the deficit criterion of the Treaty. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

4.3. Compliance with the MTO in 2019[7]

Croatia is subject to the preventive arm of the Stability and Growth Pact. In 2019, the Council was of the opinion that Croatia complied with the Stability and Growth Pact

[7] The possible retroactive impact on output gap estimates as a result of the recession induced by the COVID-19 outbreak and the possibility of abnormal responses of government revenues to major swings in economic activity underline that compared to the structural balance the expenditure benchmark is likely to provide a more reliable and predictable indicator in times of severe economic downturn.

and did not recommend a fiscal adjustment path under the European Semester. Croatia's structural balance deteriorated somewhat in 2019, but at -1.2% of GDP it remained comfortably above its medium-term objective (-1.75% of GDP).

Table 5: Compliance with the requirements under the preventive arm

	(% of GDP)	2019	2020		2021	
	Background budgetary indicators[1]					
(1)	Medium-term objective (MTO)	-1.75				
(2)	Structural balance[2] (COM)	-1.2				
	Setting the required adjustment to the MTO					
(3)	Structural balance based on freezing (COM)	-0.8				
(4) = (1) - (3)	Position vis-a -vis the MTO[3]	At or above the MTO				
(5)	Required adjustment[4]	0.0				
(6)	Required adjustment corrected[5]	-1.4				
(8)	Corresponding expenditure benchmark[6]	6.4				
	Compliance with the required adjustment to the MTO					
		COM	**COM**	**CP**	**COM**	**CP**
	Structural balance pillar					
(8) = Δ (2)	Change in structural balance[7]	Compliance				
(9) = (8) - (6)	*One-year deviation from the required adjustment*[8]					
	Two-year average deviation from the required adjustment[8]					
	Expenditure benchmark pillar					
(10)	Net public expenditure annual growth corrected for one-offs[9]					
(11) = (10) - (8)	One-year deviation adjusted for one-offs[10]					
	Two-year deviation adjusted for one-offs[10]					
	Finding of the overall assessment					
	Compliance with the debt criterion					
	Gap to the debt benchmark[11]	-2.7	3.6	n.a.	0.6	n.a.

Legend

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected

[7] Change in the structural balance compared to year t-1. Ex post assessment (for 20XX-1) is carried out on the basis of Commission 20XX spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable

[11] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction

Source:

Convergence Programme (CP); Commission 2020 spring forecast (COM); Commission calculations.